No. 12,814

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,
Appellant,

vs.

P. J. LYNCH,
Appellee,

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Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee,

ON APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF WASHINGTON

BRIEF FOR P. J. LYNCH

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JURISDICTION

This action was brought in the federal district court as within the provisions of Title 28, United States Code, Sections 1346 (a) (1), and 1402 (a). P. J. Lynch, Plaintiff and appellee-appellant, is a resident of the State of Washington, and the amount sued for in the instant case was $10,000.00 including interest but exclusive of costs. (R. 3, 6, 7).

The case comes within the usual appellate jurisdiction of this Court upon appeal from final judgments in actions

at law or in equity, Title 28, United States Code, Section 1291. Final judgment was entered October 30, 1950, granting judgment to plaintiff upon the "dividend in kind" issue and dismissing plaintiff's claim based upon the "accrual of storage income" issue. (R. 18). Defendant filed notice of appeal upon the judgment granted plaintiff on December 27, 1950 (R. 19); plaintiff filed notice of appeal upon the judgment denying plaintiff recovery upon the "accrual of storage income issue" on December 28, 1950. (R. 22).

QUESTIONS PRESENTED

The appeal by the United States presents the question of whether or not a dividend of fruit to stockholders of the Washington Fruit & Produce Company, a corporation, was in fact a true dividend, as found by the Trial Court.

The appeal of P. J. Lynch presents the question of whether storage accounts of said corporation, normally and customarily not accrued, must be accrued upon dissolution and liquidation of the corporation as income, where operation of the business continues thereafter under all former stockholders as partners.

STATUTES INVOLVED

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition*—"Gross income" includes gains, profits, and income derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property;

also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * * (26 U. S. C. 1946 ed., Sec. 22).

SEC 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend*—The term "dividend" when used in this chapter * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year * * * . (26 U. S. C. 1946 ed., Sec. 115).

STATEMENT OF THE CASE

This is one of seven companion cases brought by seven individuals for the recovery of excess profits taxes and declared value excess profits taxes assessed against said persons as transferees of the Washington Fruit & Produce Company, a corporation, of Yakima, Washington. At the trial of this action it was stipulated by counsel for the respective parties that a determination of the instant case would be decisive of the same questions to be determined in the other six actions. (R. 26-27). It has further been stipulated between counsel that a determination of the instant case upon appeal will be decisive of the same questions to be determined in the other six actions now upon appeal. These six actions are entitled and numbered in United States Court of Appeals for the Ninth Circuit as follows:

Marian L. Bloxom vs. U. S. A. ..... No. 12820
Dolores Plath vs. U. S. A. ..... No. 12821
M. Gail Plath vs. U. S. A. ..... No. 12822
M. Gail Plath, Exec. vs. U. S. A. ..... No. 12823

Fred M. Plath vs. U. S. A.....No. 12824
John M. Bloxom vs. U. S. A.....No. 12825

Two questions only were presented to the Court for determination:

(1) The validity of the declaration of a dividend in kind to the stockholders of the Washington Fruit & Produce Company, a corporation; and

(2) The right of the Collector of Internal Revenue to increase the income of that corporation at the time of its liquidation by adding to the corporate income, and thus accruing as income, certain storage accounts.

The action was tried to the court without a jury. The court made and entered findings of fact and conclusions of law (R. 11-15), and entered judgment for plaintiff upon the "dividend in kind" issue in the amount of $2,152.75 plus interest as provided by law and plaintiff's costs; the judgment also dismissed with prejudice plaintiff's claim based upon the "storage accrual" issue. (R. 18, 19). Defendant appeals from the judgment in favor of plaintiff while plaintiff appeals from the judgment of dismissal.

The basic facts of the case are not in issue; primarily, the dispute involves the interpretation of certain agreed facts.

For the sake of clarity, the facts relating to the "dividend in kind" issue will be set forth first, followed by the facts relating to the "storage accrual" issue.

During the year 1944, on February 28th, a meeting of the board of trustees of the Washington Fruit & Produce Company, a corporation, was held. At this meeting there

were present Fred B. Plath, P. J. Lynch and John M. Bloxom, who held in their names all of the stock of the corporation. Of the business transacted at this meeting was the declaration of a dividend to the stockholders of 21,977 boxes of apples of field-run Winesaps out of certain lots then held at the company's warehouse and owned by the company. The dividend was to be divided among the three stockholders in ratio to their stockholdings; that is, 12,747 boxes to Plath, 5,494 boxes to Lynch and 3,736 boxes to Bloxom (R. 29, 30; Exh. 1-a). Of the total 100 shares of stock in the corporation, 58 shares belong to Plath interests, 25 shares to Lynch interests and 17 shares to Bloxom interests.

Thereafter, on February 28, 1944, Fred B. Plath, P. J. Lynch and John Bloxom entered into an agreement which provided for the pooling of the 21,977 boxes of apples; as owners of the pool, the three individuals entered into a contract with the corporation for storing, preparing for market, and marketing of the apples by the corporation (Exh. 2). It was further agreed that the corporation would charge the pool for storage, washing, sorting, etc., as these expenses were incurred, and, following sale of the apples, disburse the net proceeds to the pool owners in proportion to their respective interests in the apples. This agreement was performed, the apples were sold, and the net proceeds disbursed. The company handled the apples in the same manner as it was handling apples for other parties (R. 33).

The three stockholders considered the fair value of

the assets received as a dividend in kind as dividend income and paid taxes on such fair value for the year 1944 upon such basis. On April 29, 1944, the corporation, Washington Fruit & Produce Company, was dissolved. Later, appellee-appellant Lynch, as one of the transferees of the Washington Fruit & Produce Company, a corporation, was assessed his proportionate share of the excess profits tax and declared value excess profits tax claimed to be due the federal government from the corporation for the tax period ending April 29, 1944. The tax claimed to be due was increased by virtue of the inclusion, as income of the corporation, the sum of $8,939.79, this being the amount of excess value received by the stockholders of the corporation in the later sale of the apples distributed as dividend in kind over the basis of these apples to the corporation. This increase of income was based upon a ruling by the Commissioner of Internal Revenue, that the dividend in kind was not a true dividend.

Also during the year 1944, and prior thereto, the Washington Fruit & Produce Company, a corporation, was engaged in storing fruit and other commodities. Some of the storage was under contract with the Federal Surplus Commodities Corporation. According to the contract, payment for storage was to be contingent upon full compliance with all conditions of the agreement (Exh. 4). It was further shown by the evidence that as to this contract, as well as with all other storage provided by the corporation, it was normal procedure and custom to await shipment of the

merchandise from storage before making any charge therefor. It was further shown that such procedure was customary with the majority of warehouses in the Yakima area (R. 40, 41).

Following the dissolution of the corporation on April 29, 1944, transferee assessments were levied against appellee-appellant Lynch and all other transferees of the corporation, for excess profits tax and declared value excess profits tax, for the tax period ending April 29, 1944. The tax claimed to be due was increased by virtue of the inclusion, as income of the corporation, the sum of $37,225.96, this being the figure computed to be the worth of storage accounts as of April 29, 1944, if accrued. This increase of income was based upon a ruling that the corporation, as of the date of liquidation, had the right to payment for said storage accounts, and that said storage accounts should be accrued, and thus included as income to the corporation for that tax period. The corporate tax year normally ended on June 30th.

Thereafter, appellee-appellant paid his proportionate share of the transferee assessments and timely filed his claim for refund, which claim was rejected.

SPECIFICATION OF ERRORS

1. Inasmuch as all of appellee - appellant Lynch's claims of error as set forth in the Statement of Points on which he intends to rely on appeal (R. 22-24) are absolutely linked together, for all practical purposes, under one claim of error generally, i. e., failure of the court to render judg-

ment in favor of the plaintiff on the "storage accrual" issue, it is felt that the argument as to the error of the court should be directed generally to the "storage accrual" issue, with specific direction as follows:

(a) Failure of the Court to sustain the corporate method of accounting as properly reflecting corporate income;

(b) Action of the court in considering dissolution of corporation as of weight in determining whether storage accounts should be accrued as income; and

(c) Action of the court in sustaining Commissioner's requirement that the corporate method of accounting be set aside and that storage accounts thus be accrued as income.

ARGUMENT

In this argument appellee-appellant Lynch will present the contentions in opposition to the lower Court's dismissal of the "storage accrual" portion of the case, then take up those in support of the judgment rendered in favor of the taxpayer upon the "dividend in kind" issue, and thereafter answer the brief of appellant-appellee, United States of America.

STORAGE ACCRUAL ISSUE

A. *The method of accounting was a true reflection of corporate income.*

In the course of its operation, Washington Fruit & Produce Company, a corporation, followed a hybrid method of accounting. As with most concerns, this method of ac-

counting was not, and could not be, on a 100% cash, accrual, or completed contract basis. As in the case of the ranch, owned and operated by the corporation, ranch expenses from January 1 to the closing date of the fiscal year were capitalized as deferred charges. Crops growing or to be grown were carried over to the year in which harvest occurred (R. 125). This method of accounting for the ranch was accepted by the Internal Revenue Service. On the other hand, warehouse storage income generally was accounted for upon a completed-contract basis. As to the storage of fruit, and other commodities, it was shown that for years the procedure had been to account for expenses involved in the operation of the warehouse and the storage provided customers as these expenses were incurred. As to income from storage provided, the method tended to be a completed contract type of accounting. No charges were made to the owner of the commodity, nor was there, by custom, any right or expectation of payment for storage until such time as the fruit or other commodity was removed from storage. At that time, storage charges were computed, and if the commodity was delivered in good condition from storage, the company was then entitled to bill and receive payment (R. 40-43, 60, 65-67, 76-78). There can be no question but that the method of handling the storage accounts was a true reflection of the income from storage accounts, even though another method or other methods were used in other phases of corporate activity, and regardless of the particular name given to the method. As

stated in KENTUCKY COLOR & CHEMICAL CO. vs. GLENN, D. C. Ky., 87 F. Supp. 618, 620:

> "In the case of *Osterloh v. Lucas,* supra, the Court said, 37 F. 2d at page 278—'The case turns largely upon what is meant by the requirement that the method of accounting shall clearly reflect the income . . . In our opinion, all that is meant is that the books shall be kept fairly and honestly; and when so kept they will reflect the true income of the taxpayer within the meaning of the law. In other words, the books are controlling, unless there has been an attempt of some sort to evade the tax. This construction may work to the disadvantage of the taxpayer or the government at times, but if followed out consistently, and honestly, year after year, the result in the end will approximate equality as nearly as we can hope for in the administration of a revenue law.' "

In the instant case, in the handling of storage accounts, income had been treated in a uniform manner for many years, as to bookkeeping, claim for and receipt of payment. There has been no question of the fairness and honesty of the bookkeeping. In any individual year, it is true that the government or the taxpayer-corporation might have suffered a disadvantage, but over a period of years the method balances the equities.

In the KENTUCKY COLOR case, (supra), the court discussed the meaning of the term "clearly" in the rule requiring the method of accounting to clearly reflect a taxpayer's income. At page 620:

> "In *Huntington Securities Corporation v. Busey,* 6 Cir., 112 F. (2d) 368, 370, the term 'clearly' within this section is defined as 'plainly, honestly straightforwardly and frankly' but does not mean 'accurately,' which in its ordinary use means precisely, exactly, correctly, without error or defect. . . ."

The above quotation, together with the decision in that case, stands basically for the rule that regardless of the name given to the method of accounting or the government's desire for adherence to the cash or accrual or other basis, the only real requirement is that, over the years, the books reflect with reasonable clarity each year's income. This rule is satisfied by the method hereinabove outlined as in use by the Washington Fruit & Produce Company, the corporation. As shown, by custom and established practice, the corporate taxpayer, in assuming the duty of storage, assumed the liability for safe storage; a loss of stored goods would result in loss of right to demand storage at the end of the storage period. Likewise, by custom and established practice, book entries and demand for payment for storage awaited satisfactory removal of the property from the warehouse. Both the corporation operating the warehouse, and those owning property in storage understood the storage contract to be that there woud be no right to receive payment for storage until after it had been completed. Thus, accounting reflected income clearly.

B. *Corporate dissolution should not affect the method of accounting.*

It is the contention of the government that the dissolution of the corporation on April 29, 1944, is sufficient cause for avoiding the normal procedure of accounting for storage. Such cannot be sustained for the corporation had no right to the receipt of the storage accounts as of the date of dissolution; receipt necessarily awaited completion of

the storage contract. A demand by the corporation for payment of these accounts as of April 29, 1944, would legally have been denied. As stated in FRANKLIN COUNTY DISTILLING COMPANY vs. COMMISSIONER OF INTERNAL REVENUE, 6th Cir., 125 F. (2d) 800, 804:

> "Keeping accounts and making returns on the accrual basis as distinguished from the cash basis, import that it is the *right* to receive and not the actual receipt that determines the inclusion of the amount in gross income. When the right to receive an amount becomes fixed, the right accrues. . . .
>
> "When accounts are kept on an accrual basis, income must be accounted for in the year in which realized, although not then actually received; and deductions should be taken in the year in which the deductible items are incurred."

Had the corporation kept storage income accounts upon a true accrual basis, these accounts would have been treated as income on the date of dissolution, had they been fixed and ascertainable as of that date. However, the method was not a true accrual basis and the accounts were not definitely fixed and ascertainable as of that date, as hereinabove set forth. The method used was similar to a completed contract basis, requiring full performance before the account could be computed with any degree of accuracy, and before payment could be demanded, and then only if the fruit were released from storage in good condition.

In H. LIEBES & CO. vs. COMMISSIONER OF INTERNAL REVENUE, 9th Cir. 90 F. (2d) 932, 938, the Court states:

"The complete definition would therefore seem to be

> that income accrues to a taxpayer when there arises to him a fixed or unconditional right to receive it, if there is a reasonable expectancy that the right will be converted into money or its equivalent."

Following the citation and quotation of a number of cases on the rule that income doesn't accrue until there is an unconditional liability on behalf of a party to pay it to the taxpayer, the court states, at page 937:

> "We may conclude that income has not accrued to a taxpayer until there arises to him a fixed or unconditional right to receive it."

Thus, even were the method of accounting followed by the corporation considered to be the accrual method, the storage accounts could not be considered income as of the date of dissolution, for the reason that the right to receive the payment therefor was conditional—(1) upon completion of the storage contract and removal from the warehouse; and (2) removal of the products in good condition.

Dissolution of the corporation on April 29, 1944, did not create as income accounts which would not be definitely ascertained as probable of receipt until the completion of the storage contract.

C. *The Commissioner is without right to require a change in the method of accounting.*

As set forth herein, taxpayer-corporation had for years followed the customary procedure in accounting for storage income—that is, a completed contract of storage before income. By virtue of such manner of accounting, and because of business practices and trends, there was a true reflection of income in each year's return. The use of the

fiscal year acted as a balance wheel. There is no valid reason why the government should be entitled to disregard prior acceptable practices and require a change of accounting during the year of dissolution in order to increase taxpayer-corporation's burden. In COMMISSIONER OF INTERNAL REVENUE vs. MNOOKIN'S ESTATE, 8th Cir., 184 F. (2d) 89, 92, taxpayer reported upon the accrual basis except as to receipts from credit sales, which were reported on a cash basis. In overriding the government's contention that all receipts should have been reported upon the accrual basis, the Court said:

> "The taxpayer's method of accounting will control the time as of which income must be reported and deductions allowed. The courts hold that neither income nor deductions may be taken out of the proper accounting period for the benefit of the government or the taxpayer. *Security Flour Mills Co. v. Commissioner,* 321 U. S. 281, 285, 287, 64 S. Ct. 596, 88 L. Ed. 725."

It is, of course, definite, that the Commissioner may require a different method of accounting where the method used by the taxpayer does not clearly reflect income. However, as in the instant case, the Commissioner may not disregard an established practice apparently approved in prior years which does actually accomplish the requirements therefor. The ruling by the Commissioner here may be considered in error in two phases: (1) an apparent attempt to modify or completely change a method of accounting; and (2) an apparent attempt to identify as income that which is not income. Such action is similar to that found in COMMISSIONER OF INTERNAL REVENUE vs. ED-

WARDS DRILLING CO., 5th Cir., 95 F. (2d) 719, 720, wherein it was stated:

> "It is of course true, as the Board points out, that under the accrual method of accounting employed by petitioner, items must be accrued as income when the events occur to fix the amounts due and determine liability to pay. . . . Generally speaking, however, the income tax law is concerned, and its administration should deal only with realized losses and realized gains. . . . A strained construction in administrative efforts to accrue income should be avoided."

It is submitted that the method of accounting followed by the corporate taxpayer was correct and clearly reflective of its income; that the accrual of the storage accounts as income as of the date of dissolution constitutes a "strained construction" on the part of the Commissioner of the revenue laws; and, further, that the District Court was in error in upholding that "strained construction" and dismissing that portion of appellee-appellant's claim.

DIVIDEND IN KIND ISSUE

A. *Argument in support of judgment*

The government's opposition to the dividend in kind transaction is apparently based upon the theory that the transaction was not a "dividend" for tax purposes but was in fact a sale of the apples by the corporation with a distribution of the net proceeds to the stockholders, and further that the transaction was in fact an anticipatory assignment of income. As in the "storage accrual" issue there is little dispute as to the facts themselves.

The trustees declared a dividend of apples owned by the corporation. These apples were in lots, readily dis-

tinguishable, and each separately held in storage. Following the declaration of the dividend, the stockholders entered into a pooling agreement, and then executed a contract with the corporation for the processing, storage, sale and distribution of the fruit. Following the sale and the receipt of the sales price, the proceeds, less handling charges of the corporation, were distributed to the pool owners in accordance with each individual's share in the pool. This form of transaction has been recognized by our courts in a number of cases. (RIPY BROTHERS DISTILLERS. INC. vs. COMMISSIONER OF INTERNAL REVENUE, 11 T. C. 326; HOWELL TURPENTINE COMPANY vs. COMMISSIONER OF INTERNAL REVENUE, 5th Cir., 162 F. (2d) 319; UNITED STATES vs. CUMMINS DISTILLERIES CORPORATION, 6th Cir., 166 F. (2d) 17; HINES vs. UNITED STATES, 7th Cir., 90 F. (2d) 957).

In the RIPY case, (supra), taxpayer-corporation declared a dividend of whiskey to its stockholders, payable in warehouse receipts of one and two-tenths barrels of whiskey for each share of common stock, there being a total of 1152 barrels of whiskey to be distributed. On the next day, taxpayer corporation wrote letters to each of its 20 stockholders advising of the dividend declaration and further of the agreement on the part of the corporation's attorney to handle the paper work in connection with the sale of the whiskey. The letters included a statement that recommended the sale of the whiskey to Schenley which had a contract for future production by the corporation. Stock-

holders were requested to advise the corporation of their desire to have the corporation turn over their warehouse receipts to the attorney if such met with their approval. The barrels were at that time kept in government bonded warehouses of the corporation, under taxpayer-corporation's name. No stockholder could have obtained his whiskey from the warehouse due to licensing requirements and failure to have the warehouse receipts.

Thereafter, the corporation delivered the receipts to its attorney, but the date of delivery preceded the date fixed in the resolution declaring the dividend as the date for payment of the dividend in kind. Within one week, counsel for the corporation sold the warehouse receipts to an affiliate of Schenley. These receipts were delivered without the endorsement of any of the stockholders, having only the endorsement of taxpayer-corporation. Net proceeds of the sale were delivered to stockholders six weeks after the dividend declaration and twenty-four days after delivery of the receipts to the attorney. The Commissioner ruled that the profits of the sale should be taxable to the corporation.

The Tax Court sets forth in the opinion that basically the question to be determined is whether the subsequent sale was by the stockholders or by the corporation, it being the government's contention that although the transaction was in form the declaration of a dividend in kind with sale by stockholders, in substance it was a sale by the corporation. And the Court further states that this is a question

of fact. It was shown that the receipts were delivered to the attorney without restriction, as negotiable instruments. The inability of the stockholders to obtain actual possession of the whiskey was held to be immaterial. Whiskey was scarce; there was a seller's market, except as to price which was regulated. After citing the CUMMINS case, the Tax Court held that the dividend in kind was correct and that the sale was by the stockholders through the attorney as their agent.

In the CUMMINS DISTILLERIES case (supra), the directors discussed liquidation of the corporation for some months and finally called a stockholders' meeting to reach some conclusion on the matter. At the meeting complete liquidation and dissolution was authorized. The plan included the distribution to common stock owners of warehouse receipts for 51,694 barrels of whiskey. Shortly thereafter the stockholders elected a committee to receive title to the receipts, sell them, and distribute the proceeds. Substitute receipts were issued upon the committee securing the release of indebtedness against the original receipts. The committee then obtained the services of a whiskey broker to sell the receipts, which was done. Within a month from the time the original plan had been adopted, the net proceeds had been distributed to the majority of the stockholders.

In the CUMMINS opinion, the Sixth Circuit Court sustains the rule that there is nothing unlawful or unethical in a taxpayer taking steps to avoid the burden of taxation.

Quoting from CHISHOLM vs. COMMISSIONER OF INTERNAL REVENUE, 2nd Cir., 79 F. (2d) 14, 15, the court says:

> "The question always is whether the transaction under scrutiny is in fact what it appears to be in form. . . . The purpose which counts is one which defeats or contradicts the apparent transaction, not the purpose to escape taxation."

In sustaining the transaction in the CUMMINS case (supra), the court, on page 21, says:

> " . . . where the corporation declares and pays a dividend in kind to its stockholders and the stockholders upon their own responsibility dispose of corporate assets so assigned, a gain realized from this sale may result in income to stockholders but none to the corporation. . . . That is this case. The corporation here involved had neither agreed nor negotiated for the sale of its assets prior to liquidation. It had had no dealings with Weiss. It had been considering liquidation for some time prior to actual decision and the reasons for so deciding are plain. The liquidation was not unreal or a sham. The stockholders acted upon their own responsibility and at their own risk . . . the receipts were in law and in fact sold by the stockholders or on their behalf and not by the corporation."

Taking the viewpoint of the CUMMINS and RIPY cases, and applying it to the instant case, it is readily apparent that a legitimate dividend in kind was declared by the trustees; the apples distributed were in the warehouse in distinguishable lots and available to any stockholder who might wish to obtain them. Constructive possession was taken by the stockholders. As in the RIPY case, there was a ready market for the apples, and it was only natural that the apples would be sold within the near future, because

of that fact and the perishable nature of the commodity. There was no economic reason why the stockholders, as owners of the apples, should transfer them to some other fruit warehouse for processing, shipping, and selling. To do so would have been taking a ridiculous step. Thus, the agreement was made between the stockholders, as owners of the pool, and the corporation, for the handling and selling of the apples, and the remitting of net proceeds, as agents for the pool owners. These apples had not been sold nor had the corporation entered into agreements to sell the apples prior to the distribution. At most there was an available market as in the RIPY case.

B. *Answer to brief of appellant-appellee United States of America.*

Primarily, there is little dispute between appellant-appellee and appellee-appellant as to either the facts or the law; the dispute arises in the interpretation of the facts and the application of the law. A reading of the Statement and Arguments contained in the Government's brief, indicates that the objections to the validity of the dividend in kind transaction stem, in the main, from an emphasis of five points:

(a) the purpose of the declaration being the saving of income taxes;

(b) the contract between the stockholders and the corporation for the marketing of the apples was entered into on the same day as the declaration of the dividend;

(c) the stockholders at no time took actual physical possession of the apples or moved the apples from their separate locations within the warehouse;

(d) the apples were sold within a two months' period after the declaration of the dividend;
(e) the corporation had orders available for acceptance at the time of the declaration of the dividend.

From these five points, appellant-appellee argues that the dividend was a sham and an anticipatory assignment of income. We shall answer these contentions by a discussion of the above five points.

(1) *The Facts:*

Appellant-appellee argues that because of the testimony that the purpose of the declaration was to "save income tax" (R. 97), the dividend in kind was not a genuine transaction. The theory appears to be that taxpayers shall never take any step, regardless of its legality, if the desire is to reduce or avoid the payment of taxes. "Business purpose" is a claimed requisite to validate all actions. Individuals and corporations engage in business for the sole purpose of making profits; taxes reduce profits. What better business purpose can be found, from the viewpoint of the taxpaying businessman or corporation, than the reduction of taxes resulting in the increase of profits. So long as the transaction in question is clearly a valid dividend with subsequent profits to those receiving the dividends, the desire to reduce taxes is immaterial. This desire becomes important and material when the transaction is clearly one to set aside that which is actually the profit of the corporation, as in the cases cited by appellant-appellee, COMMISSIONER v. COURT HOLDING CO., 324 U. S. 331, 89 L. Ed. 981, 65 S. Ct. 707; COMMISSIONER vs. FIRST STATE

BANK, 5th Cir., 168 F. (2d) 1004. As stated in GREGORY vs. HELVERING, 293 U. S. 465, 469, 79 L. Ed. 596, 55 S. Ct. 266:

> "It is quite true that if a reorganization in reality was effected, within the meaning of subdivision (B), the ulterior purpose mentioned will be disregarded. The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted."

In other words, if the transaction is proper, a taxpayer is entitled to enter that transaction to reduce or avoid taxes. The United States, on the other hand, attempts to invoke a rule that if the primary motive is to reduce or avoid taxes, the transaction is automatically a sham. Such was and is not the intent of our Supreme Court, as indicated in the GREGORY case, supra.

Appellant-appellee seeks to hold the declaration of the dividend a sham because of the speed with which the transaction occurred, both as to the execution of the contract between the stockholders and the corporation, and the sale of the apples. The cases of CUMMINS DISTILLERIES, HOWELL TURPENTINE, RIPY BROTHERS DISTILLERIES, and HINES, supra, are a complete answer. In the HOWELL TURPENTINE case, (supra), the facts are as to the speed closely similar to the instant case, and the dividend was sustained. The instant case has additional factors requiring urgent action. As shown by the testimony, apples are harvested in the fall and placed in cold storage warehouses. Prior to sale, the apples must be washed, sorted and packed before shipping. All apples are normally

sold before the end of the summer following their harvest. These apples had not been washed, sorted and packed, and it was necessary that immediate action be taken for their sale within the two months following the dividend; any sale after April required packing prior to February, the date of the declaration (R. 65). This, then, indicates the basis for the speed with which the stockholders began action to sell and did sell the apples. Loss of time meant a loss of fruit through deterioration, and thus loss of profits to the owners of the pool, the stockholders.

The additional contention by appellant-appellee is that the dividend in kind was a sham because the actual physical possession of the apples was never changed. As stated previously, the apples were in lots, marked and segregated, in the warehouse. It was to the advantage of the pool owners to contract with the corporation for their handling; it was to the advantage of the corporation to earn a profit on this handling. No good business reason existed for the taking of physical possession by the stockholders, although they had this right. A transfer to another warehouse for handling would merely have increased the cost to the individual owners. All representative stockholders were active in the business where the apples were stored and, therefore, had physical possession of all the marked lots declared as a dividend. The pattern of procedure set forth by the contract between the pool owners and the corporation, and thereafter consummated, was the most efficient, economical manner of handling the fruit.

The fifth contention of the appellant-appellee is that there was not a true dividend because there were many available orders. This situation existed in the RIPY case, supra. From the situation of available orders, appellant-appellee attempts to find a sale by the corporation. Admittedly a seller's market existed, but a seller's market does not create a sale. No sale had been achieved or even orally promised by the corporation until the corporation, as agent for the pool owners, had completed all washing, sorting, packing, *and the fruit was ready to ship* (R. 51). Contrary to statements of United States' attorneys in their brief, there were no unfilled orders on hand. Orders may have been available, but actually none were on hand.

(2) *The Law:*

From the foregoing five points, mainly, appellant-appellee claims that the dividend in kind was an anticipatory assignment of income, and a sham. The law as set forth in the government's brief on page 9, paragraph A, is not opposed by appellee-appellant. However, it must be remembered that the four cases cited at that point, without question, involved sales by the corporation, or at least final negotiations by the corporation, ultimately concluded by the stockholders. Here we have no prior sales, nor even negotiations.

Some mention should be made of the COURT HOLDING case, (supra), and UNITED STATES vs. CUMBERLAND PUB. SERV. CO., 338 U. S. 451, 94 L. Ed. 251. Appellant-appellee, at page 11, attempts to point out that

the distinction between the two cases is a distinction as to rules of law. Actually, the outcome of the two cases differed only upon findings of fact made by the lower court. On the one hand was a finding that the sale which was effected was made by the shareholders rather than the corporation; on the other hand was a finding that the sale was made by the corporation. The findings in each case presented to the court the opportunity to recite two different rules of law. As stated in the CUMBERLAND case, at page 453:

> "Our Court Holding Co. decision rested on findings of fact by the Tax Court that a sale had been made and gains realized by the taxpayer corporation."

And in footnote 3, page 454, the Court says:

> "What we said in the *Court Holding Co.* case was an approval of the action of the Tax Court in looking beyond the papers executed by the corporation and shareholders in order to determine whether the sale there had actually been made by the corporation. We were but emphasizing the established principle that in resolving such questions as to who made a sale, fact-finding tribunals in tax cases can consider motives, intent, and conduct in addition to what appears in written instruments used by parties to control rights as among themselves."

And on page 456:

> "Here, as in the *Court Holding Co.* case, we accept the ultimate findings of fact of the trial tribunal."

It is submitted that the trial tribunal in the instant case made an express finding that the "dividend in kind was a true dividend, taxable as income to the stockholders" (R. 13), and that such finding should be accepted by this Court.

Appellant-appellee claims that the dividend was an anticipatory assignment of income, citing the FIRST STATE BANK case, (supra), and other cases as authority. The distinction between the instant case and the FIRST STATE BANK case is so apparent as to hardly require mention. In the latter case, the alleged dividend was of promissory notes previously charged off as worthless by the Bank. Thus, there was no value to the Bank; the notes did not represent assets but rather potential income. The only action required was collection. In the instant case, the dividend was of corporate assets; the increase in value and resulting income was brought about by processing of the product. That income could not have been obtained but for the processing. OPA governed maximum prices, but did not guarantee a sales price to the stockholders had the price of apples fallen after the dividend declaration. The difference in the value of the apples between the declaration date and after processing is the income in question in this case; thus it can hardly be said that the dividend automatically established the resulting profit. Time, effort, and money increased the value after declaration; the sale of the apples without processing would have resulted in no profit to the stockholders or the corporation.

Appellant-appellee, on page 16 of the brief, makes the following claim:

> "The apples in the corporation's hands without regard to the dividend in kind were more than merely potential income because, as we have pointed out, the corporation had but to accept already existent orders for

> them at the price fixed by O. P. A. prior to the declaration of the dividend. In fact the dividend and the contract of February 28, 1944, would not, apparently, have been made had that not been true."

These statements are not only unsupported by the evidence but are completely without basis. Acceptance of orders on unprocessed fruit prior to the dividend declaration would, of course, not have resulted in the sales price ultimately obtained, as pointed out above. And a maximum sales price by regulation does not guarantee a sale at that price, especially in such a fluctuating market as fruit. It is not known from what source the second sentence of the above quotation was obtained, but we wish to emphasize that there exists no basis for the statement.

The sole questions for determination on the dividend in kind issue are (1) was a dividend in kind intended, and (2) was the resulting situation in keeping with that intention. The District Court has answered these questions in the affirmative by finding that the stockholders took over the assets, assumed the risks of ownership, and following the improvement of the commodity at cost, received a benefit from the sale.

CONCLUSION

The decision of the District Court should be affirmed as to the judgment granted appellee-appellant on the "dividend in kind" issue, and should be reversed as to the judgment of dismissal with prejudice on the "accrual of storage income" issue.

Respectfully submitted,

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